MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) Financial intermediaries and, particularly, banks have the ability to avoid the free-rider problem as long as they primarily
   A) acquire a diversified portfolio of stocks.
   B) make private loans.
   C) buy junk bonds.
   D) do a balanced combination of (a) and (b) of the above.

2) Which of the following do banks hold as insurance against the high cost of deposit outflows?
   A) Secondary reserves
   B) Excess reserves
   C) Bank equity capital
   D) Each of the above
   E) Only (a) and (b) of the above

3) Solutions to the moral hazard problem include
   A) greater reliance on debt contracts and less on equity contracts.
   B) monitoring and enforcement of restrictive covenants.
   C) high net worth.
   D) all of the above.
   E) only (a) and (b) of the above.

4) Because of the adverse selection problem,
   A) lenders may refuse loans to individuals with high net worth, because of their greater proclivity to "skip town."
   B) good credit risks are more likely to seek loans causing lenders to make a disproportionate amount of loans to good credit risks.
   C) in the light of recent accounting scandals related with Enron and other big firms, lenders are now reluctant to buy new issues in the commercial paper market.
   D) all of the above.

5) A major controversy involving the banking industry in its early years was
   A) whether banks should be allowed to issue their own bank notes.
   B) what percent of deposits banks should hold as fractional reserves.
   C) whether the federal government or the states should charter banks.
   D) whether banks should both accept deposits and make loans or whether these functions should be separated into different institutions.
6) Because of their _____ liquidity, _____ U.S. government securities are called secondary reserves.
   A) high; short-term        B) low; long-term        C) high; long-term        D) low; short-term

7) The too-big-to-fail policy
   A) exacerbates moral hazard problems.
   B) puts large banks at a competitive disadvantage in attracting large deposits.
   C) treats large depositors of small banks inequitably when compared to depositors of large banks.
   D) does only (a) and (c) of the above.

8) When you deposit $50 in your account at First National Bank and a $100 check you have written on
   this account is cashed at Chemical Bank, then
   A) the reserves at First National increase by $50.
   B) the liabilities of First National decrease by $50.
   C) the liabilities at Chemical Bank increase by $50.
   D) only (a) and (b) of the above occur.

9) The policy of regulatory forbearance
   A) meant delaying the closing of "zombie S&Ls" as their losses mounted during the 1980s.
   B) benefited "zombie S&Ls" at the expense of healthy S&Ls, as healthy institutions lost deposits to
      insolvent institutions.
   C) had the advantage that it benefited healthy S&Ls by giving them the opportunity to attract
      deposits that began to leave the "zombie S&Ls".
   D) both (a) and (b) of the above.
   E) both (a) and (c) of the above.

10) The spectacular growth in international banking can be explained by
    A) the desire for U.S. banks to expand.
    B) only (a) and (b) of the above.
    C) the desire for U.S. banks to escape burdensome domestic regulations.
    D) all of the above.
    E) the rapid growth in international trade.

11) Bank loans from the Federal Reserve are called _____ and represent a _____ of funds.
    A) fed funds; use        B) discount loans; source
    C) fed funds; source     D) discount loans; use

12) A bank's balance sheet
    A) lists sources and uses of bank funds.
    B) shows that total assets equals total liabilities plus equity capital.
    C) indicates whether or not the bank is profitable.
    D) does all of the above.
    E) does only (a) and (b) of the above.
13) Which of the following statements most accurately describes the task of bank asset management?
A) Banks seek to prevent bank failure at all cost; since a failed bank earns no profit, liquidity needs supersede the desire for profits.
B) Banks seek to have the highest liquidity possible subject to earning a positive rate of return on their operations.
C) Banks seek the highest returns possible subject to minimizing risk and making adequate provisions for liquidity.
D) None of the above accurately describes the task of asset management.

14) The large number of banks in the United States is an indication of
A) only efficient banks operating within the United States.
B) lack of competition within the banking industry.
C) vigorous competition within the banking industry.
D) none of the above.

15) Financial intermediaries, particularly banks,
A) overcome the free-rider problem by primarily making private loans, rather than purchasing securities that are traded in the open market.
B) are experts in the production of information about firms so that it can sort good risks from bad ones.
C) play a greater role in moving funds to corporations than do securities markets.
D) all of the above.
E) only (a) and (b) of the above.

16) The existence of deposit insurance can increase the likelihood that depositors will need deposit protection, as banks with deposit insurance
A) are placed at a competitive disadvantage in acquiring funds.
B) are likely to be too conservative, reducing the probability of turning a profit.
C) are likely to regard deposits as an unattractive source of funds due to depositors' demands for safety.
D) are likely to take on greater risks than they otherwise would.